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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 264.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

PAN AMERICAN LIFE INSURANCE COMPANY, *Respondent.*

On Writ of Certiorari to the U. S. Circuit Court of Appeals for the Fifth Circuit.

BRIEF OF PAN AMERICAN LIFE INSURANCE COMPANY, RESPONDENT.

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JURISDICTIONAL AUTHORITY

Writ of Certiorari under Sec. 240 (a), of the Judicial Code as amended by Act of February 13, 1925, granted on petition of Commissioner of Internal Revenue, on October 28th, 1940, to the U. S. Circuit Court of Appeals for the Fifth Circuit.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1932:
Sec. 201 (a)
Sec. 203 (a) (2)

The Regulations involved will be found in the Appendix hereto.

QUESTION PRESENTED

Whether reserves required by state laws to be maintained by a life insurance company for total and permanent disability benefits on policies of combined life, health and accident insurance constitute "reserve funds required by law," within the meaning of Section 203 (a) (2) of the Revenue Act of 1932.

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PAN AMERICAN LIFE INSURANCE COMPANY, *Respondent.*

On Writ of Certiorari to the U. S. Circuit Court of Appeals for the Fifth Circuit.

BRIEF OF PAN AMERICAN LIFE INSURANCE COMPANY, RESPONDENT.

NATURE OF THE PROCEEDINGS.

These proceedings were initiated by the petition of the Pan American Life Insurance Company to the U. S. Board of Tax Appeals for a review of the ruling of the Commissioner of Internal Revenue levying a deficiency in the income tax payment of said Company for the year 1933.

Being dissatisfied, in part, with the ruling of the Board of Tax Appeals, the Commissioner of Internal Revenue petitioned the U. S. Circuit Court of Appeals, Fifth Circuit, for a review of the Board's ruling. The ruling of the Board was affirmed by the Circuit Court of Appeals, whereupon the Commissioner of Internal Revenue applied to this Court for a writ of certiorari which was granted on October 28th, 1940, ... U. S. .....

For simplicity, the Pan American Life Insurance Company will be referred to in this brief as "Respondent"—the capacity in which it appears before this Court.

QUESTION PRESENTED.

Whether reserves required by state laws to be maintained by a life insurance company for total and permanent disability benefits on policies of combined life, health, and accident insurance constitute "reserve funds required by law," within the meaning of Section 203 (a) (2) of the Revenue Act of 1932.

STATEMENT OF THE CASE.

Respondent is a life insurance company, incorporated under the laws of the State of Louisiana, with its principal office in the city of New Orleans.

The only issue here is on the refusal of the Commissioner to allow, in Respondent's 1933 income tax return, a deduction of,

> 3¾% on the mean reserve of $345,083.13 on non-cancellable premium waiver and monthly income benefits under Respondent's policies.

The said reserve is required by law as an incurred liability under Respondent's exhibits "C" and "D" (R. 16A and 16J) for benefits known as,

(1) Waiver of premium, (R. 16-G) and

(2) Both waiver of premiums and payment of a monthly income in case of total and permanent disability, (R. 16-O).

Referring to the two said non-cancellable benefits attached to Respondent's life insurance policies, it is stipulated (R. 13):

> "In 1933 petitioner maintained a reserve for unpaid and unresisted claims incurred under said disability provisions of the type attached to exhibits 'C' and 'D'. That the amount of the reserves so maintained is as set forth in the following table:

	Beginning of Year	End of Year
Reserve for premium waiver benefits	$93,375.27	$113,674.60
Reserve for monthly income benefits	217,875.64	265,240.76
	311,250.91	378,915.36"

Referring to the territory in which Respondent operates, it is also stipulated (R. 13):

> "That among the states in which the Petitioner transacted business in the calendar year 1933 were Louisiana, Oklahoma, Indiana and Illinois. That in 1933 it issued life insurance policies with non-cancellable premium waiver benefits as well as policies with both non-cancellable monthly income benefits and premium waiver benefits in the event of the insured becoming totally and permanently disabled by accident or disease; copies of such policies, with disability provisions attached, being annexed hereto and made a part hereof and marked Exhibits 'C' and 'D' respectively."

The uncontradicted testimony of Mr. Edward F. Holtzman, Assistant Actuary of Respondent (R. 76-77) is that the reserve of Respondent under the said non-cancellable total and permanent disability benefits is set up under Hunter's Rate of Termination of Disability on Disabled Lives"; that the amount of the said reserve at the end of any year is the equivalent of the reserve at the end of the previous year, plus the present value, or reserve, on disability claims incurred during the current year, and less the re-

serves released by recoveries during the current year, plus compound interest at 3½% per annum; that recoveries occur by either the death of the insured, or by his recovery from disability; *that such reserves are all probable reserves, according to the said Hunter's Table, to pay benefits incurred but not yet due; that the said Table deals in probable deaths and probable recoveries from disability; that the reserve for the waiver of premium benefit is the probable amount that the company would need to take care of the amount of premium waived under the said benefit, discounted at the rate of 3½% compound interest;* that the other reserve for the monthly income disability benefit is calculated under the said Hunter's Table in the same manner as is the amount of reserve for premium waiver benefit and that while the said benefits are incurred by the occurrence of disability, *the amount payable thereunder depends upon the continued life of the insured and the continuance of his disability,* and that any unpaid portion of the reserve is *recovered upon the death of the insured or termination of his disability;* that the said reserves are calculated in the same manner and under the same Table as the reserves for non-cancellable health and accident insurance policies; *that the said reserves are set up upon the occurrence of disability, as an incurred liability, recoverable either by the death of the insured, or by termination of his disability, and that the actual amount ultimately to be paid is uncertain because it is dependent upon the said contingencies of the insured surviving or his recovery.*

In its Findings of Fact, the Board found (38 B. T. A. 1430):

> "More than 50 per centum of its total reserve funds held during the taxable year were held for the fulfillment of its life insurance and annuity contracts." (R. 36.)

At the time of the preparation of this brief, Respondent has not been furnished with a copy of the brief Commissioner will file in this Court but, in connection with the

above stipulation covering the states where Respondent does business, in his brief in the Circuit Court of Appeals, the Commissioner said:

> "It is conceded that the so-called reserves in controversy here were required to be maintained by the laws of the several states in which the taxpayer did business. * * *

And, in connection with the question of the reserves being technical in character, it was said in his brief:

> "(b) *The nature and method of computation of the so-called reserve for incurred disability benefits here in controversy.*
>
> "It will not be disputed that the taxpayer's so-called 'reserve for incurred disability benefits' was computed by the taxpayer upon the basis of a table of probabilities showing the rates of death and recovery from disability, known as 'Hunter's Rate of Termination of Disability on Disabled Lives.' From the findings of the Board (R. 38-39) it appears that the manner of setting up this reserve is to set up the present value of probable future benefits, and that this is done 'by discounting the probable future benefits (either the waiver of premiums or both the waiver of premiums and the payment of a monthly income) at 3½ per centum compound interest, and reducing that amount with the aid of a Hunter's Table by the probability of the insured living and still being totally and permanently disabled on the premium due date.'
>
> "In other words, this so-called reserve was held by the taxpayer to meet its obligation to waive premiums, or to waive premiums and to pay a monthly income, depending upon the type of policy, in cases of total and permanent disability *where the insured had already become disabled.*
>
> "Here lies the crux of this case, it clearly appearing that the Court is here dealing with so-called reserves held against disabilities already incurred.
>
> "The issue here is not whether the taxpayer's so-called 'reserve for incurred disability benefits' was required to be maintained by state laws, but whether it constitutes 'reserve funds required by law' within the

meaning of the federal taxing statutes. Stated in another way, was this 'reserve for incurred disability benefits' held against *life risks* or was it a mere 'solvency' reserve which the taxpayer was required to maintain by state laws to insure the performance of its supplementary health and accident insurance contract obligations. New York Ins. Co. v. Edwards, 271 U. S. 109, 117-119."

"(c) *The Commissioner's position.*

It is the position of the Commissioner that only those reserves which are held for life risks on *life insurance contracts* in force and unmatured, constitute 'reserve funds required by law' within the meaning of the federal statutes."

SUMMARY OF ARGUMENT.

A company issuing life insurance and annuity contracts (including contracts of combined life, health and accident insurance) is taxed as a "life insurance company" if the reserve funds held for the fulfillment of such contracts comprise more than 50 per centum of its total reserves (1932 Revenue Act, Sec. 201 (a)). Hence, it is permitted to deduct from its gross investment income 3¾ per centum of its interest bearing reserves required by law and compiled upon a standard table of probabilities (1932 Revenue Act, Sec. 203 (a) (2)).

Interest bearing reserve funds, exacted under state laws, held for the payment of future disability benefits, if the disabled policyholder survives, and if he remains disabled, based upon assumption made under a recognized actuarial table, constitute *"reserve funds required by law"* within the meaning of Sec. 203 (a) (2). Reserve funds so held are based upon probabilities, and do *not* become a fixed liability, like that of *a solvency reserve*, as is contended by the Commissioner.

There are no decisions of the United States Supreme Court, nor of the Circuit Courts of Appeals, sustaining the contention of the Commissioner to the effect that only life

insurance reserves under life insurance policies and maintained to meet death claims are deductible: on the other hand, there are three decisions of Circuit Courts of Appeals which hold to the contrary: *Pan American Life Insurance Company* v. *Commissioner* (5th Circuit), 111 Fed. (2d) 366; *Commissioner* v. *Oregon Mutual Life Insurance Company* (9th Circuit), 112 Fed. (2d) 468; *Commissioner* v. *Monarch Life Insurance Company* (1st Circuit), 114 Fed. (2d) 314. The decision of the Court of Claims in *New World Life Insurance Company* v. *United States*, 26 Fed. Supp. 444, is erroneous and contrary to the decisions of three different Circuit Courts of Appeals.

The right of Respondent to deduct 3¾ per centum of such disability reserves had been recognized by the Commissioner since 1921 and was expressly recognized by Treasury Regulations of 1932 in effect during the taxable year in question—1933.

A subsequent change in the Treasury Regulations in 1935 has no retroactive effect and is not binding on Respondent with respect to its income taxes for the year 1933. (*Helvering* v. *R. J. Reynolds Tobacco Company*, 306 U. S. 110; *Helvering* v. *Wilshire Oil Company, Inc.*, 308 U. S. 90.).

ARGUMENT.

Prior to the Revenue Act of 1921 life insurance companies were taxed the same as all other corporations on their *net income from all sources, with a right to deduct from gross income the net additions, if any, made within the taxable year to reserve funds required by law.*

However, because so much of the premium income of a life insurance company (perhaps 60%) is required by state laws to be set up as an interest bearing reserve, the plan of taxing life insurance companies on the same basis as all other corporations proved unsatisfactory to both the Government and to the companies. After hearings held before the Senate Finance Committee, a plan was arrived at of taxing *gross* income from investments, but allowing a deduction therefrom of a sum not greater than 4% of the "*re-*

serve funds required by law"; also allowing a deduction therefrom of certain investment expenses.

The said plan was first incorporated in the Revenue Act of 1921, Sec. 242 and Sec. 245. Sec. 242 was reenacted under that number in each of the subsequent Acts of 1924 and 1926, and then under Sec. 201 (a) of the Act of 1928 and each Act thereafter including the Act of 1939. Sec. 245 (a) (2) was reenacted in the subsequent Acts, and is now 203 (a) (2).

The pertinent provisions of Secs. 201 (a), 202 and 203 (a) read as follows:

> "Sec. 201 (a) Definition.—When used in this title the term 'life insurance company' means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.
>
> "Sec. 202. *Gross Income of Life Insurance Companies.* (a) In the case of a life insurance company the term 'gross income' means the gross amount of income received during the taxable year from interest, dividends, and rents.
>
> "Sec. 203. *Net Income of Life Insurance Companies.* (a) *General Rule.*—In the case of a life insurance company the term 'net income' means the gross income less—
>
> (2) 'Reserve Funds.—An amount equal to 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per centum shall be substituted for 4 per centum.'"

It will be seen that the said plan of taxing life insurance companies has been the law for the past nineteen years. *It will be hereafter shown that the Treasury Department regulations, until 1935, allowed life insurance companies to deduct 3¾% on the mean reserve required by law on incurred disability benefits.*

The Board of Tax Appeals, in *Equitable Life* v. *Commissioner*, 33 B. T. A. 708, passed on the question of whether or not reserves for non-cancellable accident and health policies issued by a life insurance company were mere solvency reserves or deductible reserves required by law, within the meaning of Sec. 203 (a) (2). The Board ruled that such reserves were not solvency reserves, but were interest bearing reserves, required by state laws to be held:

> "* * * for the payment of benefits *which will become due in the future, if the policyholders survive and remain disabled.*"

The Board also ruled that the reserves were based upon scientific tables of probabilities, dealing with life contingencies, and therefore were deductible.

The Board of Tax Appeals thereafter ruled upon the right of a life insurance company, issuing *combined life and disability policies*, to deduct on its disability reserves the 4% allowed by Sec. 203 (a) (2), in the following cases:

Monarch Life Insurance Company v. *Commissioner*, 38 B. T. A. 716.
Pan American Life Insurance Company v. *Commissioner*, 38 B. T. A. 1430.
Oregon Mutual Life Insurance Company v. *Commissioner*, 39 B. T. A. 1239.

In each case the Board followed its ruling in the *Equitable Life* case, *supra*. The Commissioner sought a review of the Board's ruling in each case, and three different Circuit Courts of Appeal, by unanimous opinions, affirmed the ruling of the Board.

The first of these cases to be decided by a Circuit Court of Appeals was the case at Bar, decided on April 20, 1940, by the Circuit Court of Appeals, Fifth Circuit, reported in 111 Fed. (2d) 366, which was followed by the decision of the Circuit Court of Appeals, Ninth Circuit, on June 12, 1940, in *Commissioner* v. *Oregon Mutual Life Insurance Company*, 112 F. (2d) 468, and, shortly thereafter, was followed by the Circuit Court of Appeals, First Circuit, on August

15, 1940, in *Commissioner* v. *Monarch Life Insurance Company*, 114 F. (2d) 314.

In the case here, the opinion of the Circuit Court of Appeals, Fifth Circuit, (pp. 367 and 368) says:

> "The taxpayer is an insurance company incorporated under the laws of Louisiana. During the tax year 1933, it did business in Louisiana, Oklahoma, Indiana, and Illinois. More than fifty per centum of its total reserve funds was held for the fulfillment of its life insurance and annuity contracts. Some of its policies provided for the waiver of premiums in event of the total and permanent disability of the insured, so long as such disability continued; others provided for the payment of monthly disability benefits. The laws of Oklahoma and Illinois required the insurer to maintain reserves for unpaid and unresisted claims incurred under these disability provisions. The taxpayer maintained such reserves computed according to a standard method. They were established only for the policies under which the insured had sustained total and permanent disability, and the continuance of benefits was subject to termination either by death or recovery from disability. In its tax return, the insurer computed the mean of such reserve funds held at the beginning and end of the taxable year, and deducted three and three-fourths per centum thereof, which the commissioner disallowed.
>
> "Section 201 (a) of the Revenue Act of 1932 defines a life insurance company to be a company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which, held for the fulfillment of such contracts, comprised more than fifty per centum of its total reserve funds.
>
> "This question has been before the Board of Tax Appeals four times, and before the Court of Claims once.[1] Those portions of the law which are applicable to this case were originally enacted in 1921, and have

[1] *Equitable Life Assurance Society* v. *Commissioner*, 33 B. T. A. 708; *Monarch Life Ins. Co.* v. *Commissioner*, 38 B. T. A. 716; *Pan American Life Ins. Co.* v. *Commissioner*, *supra*; *Oregon Mutual Life Ins. Co.* v. *Commissioner* (Jan. 4, 1939); *New World Life Ins. Co.* v. *U. S.*, 26 Fed. Supp. 444.

been re-enacted in each succeeding revenue act, including that of 1939. The administrative interpretation, as evidenced by Treasury Regulation 62, Art. 681, promulgated in 1922, and unchanged in this aspect until 1935, provided that reserves for amounts incurred but not due for total and permanent disability benefits were considered reserves as contemplated by the law. No life insurance company's right to the deduction was ever protested until 1934, when, after the decision of the Court of Claims in the case of Continental Assurance Company v. United States, 8 Fed. Supp. 474, the Commissioner concluded that such deductions should not be allowed. It will thus be seen that for thirteen years, including 1933, the administrative interpretation supported the taxpayer's contention. During this period, the Congress re-enacted the provisions without change, indicating that the administrative interpretation was not inconsistent with the legislative intent.[2] The attempt of the Commissioner to apply 1935 treasury regulations to tax returns made for the year 1933 falls within the prohibition against retroactive application mentioned in Helvering v. R. J. Reynolds Tobacco Co., 306 U. S. 110.

"Since the applicable provisions of the revenue act specifically define life insurance companies to include those issuing casualty contracts, and permit the reserve funds required by law held by such companies to be partially deductible, and since there is no express provision excluding casualty reserves from the coverage of the deduction, the most that can be said in favor of the construction urged upon us by the commissioner, in the light of the administrative interpretation, is that the statute is sufficiently ambiguous to give rise to a reasonable doubt as to its meaning, which we are required to resolve in favor of the taxpayer.[3]

"The nature of the reserve in dispute is persuasive to the conclusion we have reached. Incurred disability reserves were created only after the disability had arisen. They were not fixed obligations. They were payable only in the future, and were contingent upon the continuance of both life and disability. Not being

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[2] *U. S.* v. *Dakota-Montana Co.*, 288 U. S. 459.

[3] *Old Colony Trust Company* v. *Commissioner*, 279 U. S. 716; *White* v. *Aronson*, 302 U. S. 16.

completely accrued, the extent of the probable liability thereunder was computed, and the amount of the reserve created was fixed, by tables of probability based upon approved rates of termination of such liability. The method of computation so employed is wholly consistent with that used for establishing amounts of premiums and reserves for ordinary life-insurance and annuity contracts, and is wholly inconsistent with reserves created to defray accrued and definite liabilities payable in the future. This is the distinguishing feature between the case at bar and those relied upon by the commissioner, which dealt with the reserves for the payment of accrued obligations for fixed amounts created by contract. The latter are mere solvency reserves having no relation to true insurance risks.[4]

"The purpose of Congress in allowing these deductions is obvious. By the provision enacted in 1921, life insurance companies for the first time were taxed upon their investment income only, and no deduction was allowed for claims paid to policy holders or for net additions made to reserve funds, as insurance companies classed 'other than life' were permitted by the act to do. Apparently, Congress recognized that life insurance companies were required by law to maintain numerous reserves comprising a large proportion of their total assets. Being thus deprived of potential investment returns and being required to credit such reserves with compound interest annually, the deduction was allowed as a necessary compensation for earnings foregone by compliance with the law.[5] Due to its classification for income tax purposes as a life insurance Company, the taxpayer is denied the right to claim the deductions on its casualty reserves to which casualty companies are entitled. Therefore, to deny it the deduction here claimed would have the unjust effect of declaring these reserves to be under the law for the penalties imposed by it, and outside the law for the benefits flowing from it.

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[4] *McCoach* v. *Insurance Company of North America*, 244 U. S. 585; *United States* v. *Boston Insurance Company*, 269 U. S. 197; *Helvering* v. *Inter-Mountain Life Insurance Company*, 294 U. S. 686; *Helvering* v. *Illinois Insurance Company*, 299 U. S. 88.

[5] *Cf. Mass. Mutual Life Ins. Co.* v. *U. S.* 56 F. (2d) 897.

"A further inconsistency in the position we are urged to take is evidenced by the provisions of Section 203 (a) (3) of the Revenue Act of 1932, which expressly permits percentage deductions upon casualty reserves held by life insurance companies on certain types of policies, even though not required by law. It is unreasonable to believe that Congress would discriminate between companies doing the same kind of casualty business, as the interpretation would require, when the conclusion we have reached is entirely in harmony with the theory of equal benefits. Our conclusion is that the reserve for incurred disability benefits held by the taxpayer was a fund required by law within the meaning of the statute."

In *Commissioner* v. *Oregon Mutual Life Insurance Company*, 112 F. (2d) 468, after pointing out that the reserve in question is not a "solvency reserve" but a technical reserve computed upon the basis of probability tables and an assumed rate of interest, the Ninth Circuit, in the course of its opinion (p. 470) said:

"Considerable light is thrown on the problem by the provisions of Sec. 201 (a) of the act, 26 U.S.C.A. Int. Rev. Acts, page 546. A life insurance company is there defined as 'an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.'

"As applied, for example, to this taxpayer, the Commissioner construes the statute as meaning that the determinative ratio is between the non-disability elements of the company's reserves and a total comprising these plus the reserves held for the fulfillment of the disability features of its combined policies.

"The statute, however, says that the reserve funds which are to be compared with the total shall comprise reserves held 'for the fulfillment of such contracts'—namely, the contracts enumerated. These expressly include 'contracts of combined life, health, and accident insurance'. For the purpose of classification, the disability reserves held against the combined policies are

treated by the act as life insurance reserves. N
the Commissioner nor the court is at liberty to
gard the plain language of the section on the
that the classification lacks philosophical basi
must be borne in mind that we are dealing
statute, not with an actuarial problem.

"Since the words 'reserve funds', as used in th
sification statute, embrace disability reserves
against combined life and disability policies, we
persuasive reason to believe that they should b
to mean less than that when used in Sec. 203 (a
Had Congress intended a narrower application
term for the purpose of the deduction, presuma
would have said so in apt language. The word
serve funds required by law', used in the latter s
unquestionably refer to technical insurance res
But we think, as in Sec. 201 (a), they compr
reserves held to meet a life insurance company'
gations dependent either upon life contingenc
upon life and disability contingencies. The pro
contained in the last sentence of Sec. 203 (a) (2)
strongly to support this view."

The Commissioner argued orally and in his brief
Circuit Court of Appeals, and possibly will argue i
Court, that the change in the Treasury Department r
tions in 1935, mentioned above, was made to conform
decision of this Court in *Helvering* v. *Illinois Life*
ance Company, 299 U. S. 88, and *Helvering* v. *Inter-*
tain Life Insurance Company, 294 U. S. 686, the arg
being that those cases held that there may be no ded
for reserves, even though "required by law" unless
be reserves held for life risks on life insurance cont
Without a discussion of those cases beyond pointin
that in each case the reserve in question was obviou
mere solvency reserve—a coupon reserve in the
Mountain Life case, and a survivorship investment re
in the *Illinois Life* case—a complete answer to the Co
sioner's contention is found in the opinion of the C
Court of Appeals in the *Monarch Life Insurance Co*
case, where, in 114 F. (2d), on page 325, it is said:

"While certain language in Helvering v. Illinois Life Insurance Co., supra, appears to sustain the Commissioner's contention that the reserves must be technical life insurance reserves, an examination of all the cases shows that this is not true. 'The language used in an opinion must be read in the light of the issues presented.' Sinclair v. United States, 1929, 279 U. S. 749, 767, 49 S. Ct. 471, 477, 73 L. Ed. 938, 63 A.L.R. 1258. In the Illinois Life Insurance Co. case, as in Helvering v. Inter-Mountain Life Insurance Co., and Continental Assurance Co. v. United States, supra, also relied on by the Commissioner, the court distinguished between life insurance reserves and 'solvency' reserves. There was no question of drawing any line between life insurance reserves and other true insurance reserves. The only reserves to which the language could refer in all three cases were life insurance reserves. The question here presented was not in any manner raised. The Illinois case expressly approved the Inter-Mountain decision where the court said that reserves cannot 'include values that do not directly pertain to insurance' (1935, 294 U. S. 686, 690, 55 S. Ct. 572, 575, 79 L. Ed. 1227) with no words restricting the language to 'life' insurance. And the Inter-Mountain case approved the holding of the Court of Claims in the Continental Assurance Co. supra, decision that 'the reserve intended by the taxing act as a deduction is the amount set aside from premiums and built up by interest accretions to meet existing unmatured insurance, whether fire, marine, or life insurance' 8 F. Supp. 474, 478. The reserves in question here come completely within this definition and it is our opinion that Helvering v. Illinois Life Insurance Co. supra, intended in no way to limit this definition. Commissioner v. Oregon Mutual Life Insurance Co., supra; Pan American Life Insurance Company v. Comm. of Int. Rev., 1938, 38 B.T.A. 1430, 1438, affirmed, 5 Cir. 1940, 111 F. (2d) 366."

There are, of course, many other cases holding that solvency reserves, or other reserves not involving a life contingency, are not "reserve funds required by law" within the meaning of Sec. 203 (a) (2). For convenience, in the appendix hereto, there is a summary of the reported cases

passing on the words "reserve funds required by law."

None of the said decisions of the Supreme Court, however, pass on the effect of the words in Sec. 201 (a) "(including contracts of combined life, health or accident insurance)" in the matter of taxation of disability reserves of a life insurance company issuing combined life and disability policies.

The only decision of the Supreme Court which touches on disability reserves, is *New York Life Insurance Company* v. *Edwards,* 271 U. S. 109, arising under the Revenue Act of 1913, where the net additions to reserves required by law were deductible by all classes of insurance companies; therefore, the question of life insurance reserves as defined by the Act of 1921, could not have been at issue there. In that case, it held that the Company did not show enough to establish its right to deduct its reserves under the 1913 Act, but the decision intimates that upon a proper showing the reserve might have been deductible.

There is another reason for concluding that the Commissioner is in error in his interpretation of Sec. 201 (a). It is a provision to be found in Sec. 203 (a) (2) which was alluded to by the Fifth Circuit in *Commissioner* v. *Pan American Life Insurance Company,* but not quoted in the opinion. That provision reads as follows:

> "Life insurance companies issuing policies covering life, health and accident insurance combined in one policy, issued on the weekly premium payment plan, continuing for life and not subject to cancellation, shall be allowed, in addition to the above, a deduction of 3¾ per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable years * * *."

It will thus be seen that Sec. 203 (a) (2) specifically permits an industrial company writing on the weekly premium plan *combined life and health and accident insurance in one policy, to deduct* 3¾% on its life reserves, and 3¾% on its accident and health reserves, even though such reserve fund be not required by law.

In speaking of that paragraph, the Circuit Court of Appeals, Fifth Circuit, in the *Pan American Life Insurance Company* case, (p. 368) said:

> "It is unreasonable to believe that Congress would discriminate between companies doing the same kind of casualty business, as the interpretation would require, when the conclusion we have reached is entirely in harmony with the theory of equal benefits."

In each of the cases heard by the Circuit Court of Appeals, the Commissioner relied strongly upon *New World Life Insurance Company* v. *United States*, 26 F. Supp. 444 (Court of Claims), which is the only reported case supporting the Commissioner's contention, but the Fifth Circuit (in Pan American Life) and the Ninth Circuit (in Oregon Mutual Life), without much discussion of the opinion of the Court of Claims (in New World Life) declined to follow it and affirmed the Board of Tax Appeals. However, the First Circuit (in Monarch Life) does discuss the said opinion at great length, and after first observing that the Court of Claims squarely sustained the Commissioner, the Court said it did not agree with the conclusion of the Court of Claims that an interest bearing reserve required by state laws was only a solvency reserve, and that under Sec. 201 (a) and 203 (a) (2) Congress intended to limit the reserves deductible by life insurance companies to reserves only when maintained for death benefits under a life policy; that if Congress had that intention it could have easily said so; that such interpretation of the law by the Court of Claims disregards the fact that under the Revenue Act of 1932, life insurance companies are taxed upon gross income earned on investments, and that, since the reserve funds required by law are improved with interest, it is apparent that interest, when added to reserves, is not income to the Company; that referring to the distinction attempted by the Commissioner between reserves that "belong" or "do not belong" to the Company, the statute nowhere makes such distinction, and that the question to be decided is not what "belongs" to the Company, but what

Congress wishes to tax; that the said reasoning of the Court of Claims is, in the opinion of the Court, insupportable, and that the Court prefers to follow the reasoning and the ruling of the Board of Tax Appeals and the opinions of the Circuit Court of Appeals for the Fifth Circuit (in Pan American) and of the Ninth Circuit (in Oregon Mutual) which the Court finds to be strictly in point.

The Treasury Regulations under each Revenue Act from 1921 to 1932, both inclusive, provide that "generally speaking," Items 7-11 of the liability page of the annual statement of life insurance companies *"will be considered reserves, as contemplated by the law."* An extract from Treasury Regulations of 1932, Article 971, is printed in the appendix hereto.

Item 9 of the liability page of the uniform statement of the National Convention of Insurance Commissioners (1933 form) reads as follows:

> "9. Present value of amounts *incurred but not yet* due for total and permanent disability benefits * * * $....."

An extract from the uniform statement of National Convention of Insurance Commissioners (1933 form) containing a reproduction of Items 7 to 11, inclusive, of the liability page thereof, is to be found in the appendix to this brief.

The printed Income Tax Return form prepared by the U. S. Treasury Department for use by insurance companies requires the taxpayer to set out in that return the identical information appearing in Item 9 of the liability page of the statement of the National Convention of Insurance Commissioners. An examination of Respondent's 1933 income tax return (R. 10F—Exhibit "B") will show that Line 4, under Schedule A—reserve funds, reads:

> "Reserve for Incurred Disability Benefits"

and that Respondent has entered upon that line in its 1933 Income Tax Return the reserve held by it for incurred dis-

ability benefits, being $311,250.91 at the beginning of the taxable year and $378,915.36 at the end of the taxable year; the mean of which is $345,083.13—the amount set out in the stipulation entered into between the Commissioner and Respondent (R. 13).

It is thus seen that not only did the Treasury Regulations of 1932 recognize reserves held for incurred disability benefits as deductible reserves under the Revenue Act, but the Income Tax Return form made provision for the entry of that specific data in the form.

In his brief filed in the Circuit Court of Appeals in this case, the Commissioner argued that to conform to the decisions of the Supreme Court in *Helvering* v. *Illinois Life, supra*, and *Helvering* v. *Inter-Mountain Life, supra*, he changed his Regulations in 1935 by Treasury Regulations 86, pertaining to the Revenue Act of 1934, to provide by Article 203 (a) (2)-1 that the term "reserve funds required by law" does not include:

> "* * *; liability on supplementary contracts not involving life contingencies; (or the) estimated value of future premiums which have been waived on policies after proof of total and permanent disability."

The Commissioner then asserted that since Congress reenacted Sec. 201 (a) and Sec. 203 (a) (2), the said change in Regulations is retroactive and therefore applies to Respondent's 1933 return, and "must be accepted here as controlling and having the force and effect of law."

As heretofore pointed out, there is nothing in the *Illinois Life* case or the *Inter-Mountain Life* case restricting the term "reserve required by law", as used in Sec. 203 (a) (2), to insurance reserves maintained on life insurance policies and held for death benefits. But whatever may have influenced the Commissioner to change his Regulations in 1935, such change can have no binding effect upon Respondent with respect to its 1933 income taxes.

The U. S. Supreme Court, in *Helvering* v. *R. J. Reynolds Tobacco Company*, 306 U. S. 110, expressly held that the

Secretary of the Treasury had no authority to apply the amended Regulations to years prior to the effective date of the amendment. The opinion by Mr. Justice Roberts states, page 116:

> *"We hold that respondent's tax liability for the year 1929 is to be determined in conformity to the regulation then in force."*

and at page 116:

> *"Since the legislative approval of existing regulations by reenactment of the statutory provision to which they appertain gives such regulations the force of law, we think that Congress did not intend to authorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed."*

In *Helvering* v. *Wilshire Oil Company, Inc.*, decided by the U. S. Supreme Court on November 16, 1939, 308 U. S. 90, the *Reynolds Tobacco Company* case was impliedly approved. We quote, in part, from the opinion of Mr. Justice Douglas, as follows:

> "But in any event, the validity of the regulations in question seems clear. The oft-repeated statement that administrative construction receives legislative approval by reenactment of a statutory provision, without material change (*United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459) covers the situation where the validity of administrative action standing by itself may be dubious or where ambiguities in a statute or rules are resolved by reference to administrative practice prior to reenactment of a statute; and where it does not appear that the rule or practice has been changed by the administrative agency through exercise of its continuing rule-making power. It does not mean that a regulation interpreting a provision of one act becomes frozen into another act merely by reenactment of that provision, so that that administrative interpretation cannot be changed prospectively through exercise of appropriate rule-making powers."

* * * * * * *

"The only remaining question is whether Treasury Regulations 74, Art. 221 (i) were within the power of the Commissioner to promulgate. That they were seems clear beyond question. We are not dealing here, as was this Court in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110, with regulations applied retroactively. These are applied prospectively only."

It will be seen from these two reeent decisions that the law is well settled that while the Commissioner may amend his regulations and apply them prospectively to *subsequent years*, he may not apply his amendments to *prior years*, as the Commissioner is seeking to do here with Respondent's 1933 income tax return.

As hereinabove pointed out, the Commissioner's regulations for each year from 1921 to 1935 (when the Commissioner changed his regulations) expressly authorized a deduction of the statutory percentage of the mean of Respondent's disability reserves for "premium waiver" and "premium waiver and monthly income" benefits.

In his brief filed in the Circuit Court of Appeals, the Commissioner cited the case of Estate of *Sanford* v. *Commissioner*, 308 U. S. 39 as supporting his theory of a retroactive effect of the 1933 Treasury Regulations, but that case expressly holds:

"Administrative practice may be of persuasive weight in determining the construction of a statute of doubtful meaning where the practice does not conflict with other provisions of the statute and is not so inconsistent with applicable decisions of the courts as to produce inconsistency and confusion in the administration of the law. Such a choice, in practice, of one of two possible construtions of a statute by those who are expert in the field and specially informed as to administrative needs and conveniences, tends to the wise interpretation and just administration of the law. This is the more so when reliance has been placed on the practice by those affected by it.

"But courts are not bound to accept the administration construction of a statute regardless of conse-

quences, even when disclosed in the form of ruling
See *Helvering* v. *New York Trust Co.*, 292 U. S. 4
468, 78 L. Ed. 1361, 1368, 54 S. Ct. 806."

and in head note (9):

"The courts are not bound to accept an admini
trative construction of a statute, even when that co
struction is in the form of rulings."

It will be seen from this that the Commissioner is wit
out legal right, under recent decisions of the U. S. Supre
Court, to apply his amended 1935 Regulations to Respo
dent's 1933 return, and that Regulations are not absolute
binding on the courts, and that amendments to regulatio
are approved only when they are consistent with and ma
to conform to decisions of the courts interpreting the la

Speaking of the Commissioner's contention that the Re
ulations of 1935 were retroactive, the First Circuit, in t
Monarch Life case, *supra*, used the following language:

"The regulations were not changed to exclude the
reserves until 1935. (Regulations 86, approved Fe
11, 1935). Thus for thirteen years, the administrati
practice supported the taxpayer's contention. T
Commissioner should not now be permitted to ap
retroactively against the petitioner any new regul
tions made after the tax years in question, particular
after Congressional re-enactment under the previo
regulations."

CONCLUSION.

The judgment of the Court of Appeals should be
firmed.

Respectfully submitted,

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APPENDIX.

Summary of Cases Passing on the Words "Reserve Funds Required by Law" and Holding That Liabilities of the Following Types Are Not Such Reserves:

Unpaid bills, taxes, salaries and brokerage.[1]
Unpaid death losses.[2]
Unreported death losses.[3]
Accrued but unpaid disability benefits.[4]
Deferred dividends.[5]
Annual dividends.[6]
Dividends left to accumulate at interest.[7]
Coupons left on deposit.[8]
Premiums paid in advance.[9]
Mortality fluctuation fund.[10]
Securities deposited with State Insurance Department.[11]
Deficiency reserves as required by New York Insurance Law.[12]
Survivorship funds.[13]

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[1] *Maryland Cas. Co.* v. *U. S.*, 251 U. S. 342, 349;

[2] *Mass Mutul* v. *U. S.*, 56 F. (2d) 897, 901;

[3] *N. Y. Life* v. *Edwards*, 271 U. S. 109, 119;

[4] *Mass. Mutual* v. *U. S.*, 56 F. (2d) 897, 898, 901; *Equitable Life Assur. Soc.*, 33 B. T. A. 708, 712;

[5] *Minn. Mutual* v. *U. S.*, 66 Ct. Cl. 481;

[6] *Mass. Mutual* v. *U. S.*, 56 F. (2d) 897, 901;

[7] *Mass. Mutual* v. *U. S.*, 56 F. (2d) 897; *Midland Mutual*, 19 B. T. A. 765; *Equitable Life Assur. Soc.*, 33 B. T. A. 708, 716-717;

[8] *Helvering* v. *Inter-Mountain Life*, 294 U. S. 686, 689-690; *Helvering* v. *Atlas Life*, 78 F. (2d) 166; *Helvering* v. *Missouri State Life*, 78 F. (2d) 778; *Continental Assur. Co.* v. *U. S.*, 8 F. Supp. 474, 479-483;

[9] *Midland Mutual Life*, 19 B. T. A. 765, 770; *Interstate Reserve Life*, 37 B. T. A. 54;

[10] *Old Line Ins. Co.*, 13 B. T. A. 758, 763;

[11] *Midland National Life*, 14 B. T. A. 200; *Kaskaskia Life*, 22 B. T. A. 210; *Commonwealth Life*, 31 B. T. A. 887;

[12] *North American Reassur. Co.*, 29 B. T. A. 683;

[13] *Helvering* v. *Illinois Life*, 299 U. S. 88, 90-91; *Farmers Life*, 27 B. T. A. 423.

Treasury Regulations of 1932, Art. 971.

Art. 971. Tax-exempt interest and reserve funds.—Under paragraphs (1) and (2) of section 203 (a), life insurance companies are entitled to deduct from gross income:

* * * * * * *

(2) Four per cent of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per cent shall be substituted for 4 per cent. The reserve deduction is based upon the reserves required by express statutory provisions or by the rules and regulations of the State insurance departments when promulgated in the exercise of a power conferred by statute; but such reserves do not include assets required to be held for the ordinary running expenses of the business nor do they include the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance.

* * * * * * *

* * * A company is permitted to make use of the highest aggregate reserve called for by any State in which it transacts business, but the reserve must have been actually held as shown by the annual statement. Generally speaking, the following will be considered reserves as contemplated by the law: Items 7-11 of the liability page of the annual statement for life insurance companies * * *.

Lines 7 to 11, Both Inclusive, From Annual Statement of National Convention of Insurance Commissioners—1933 Form.

7. Net Reserve (Paid for Basis), excluding disability .....$

8. Extra reserve for total and permanent disability benefits (less $ reinsurance) $ and for additional accidental benefits (less $ reinsurance) $ included in life policies .....$

9. **Present value of amounts incurred, but not yet due for total and permanent disability benefits less $ reinsurance** .....$

10. Present value of amounts not yet due on supplementary contracts *not* involving life contingencies, computed by the excluding disability claims included in Item 9 .....$

11. Liability on policies cancelled and not included in "net reserve" upon which a surrender value may be demanded.....$